

Pages 1 - 44

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

Before The Honorable Richard Seeborg, Judge

SHASTA STRATEGIC INVESTMENT)
FUND, LLC; and PRESIDIO GROWTH)
LLC (Tax Matters Partners), et)
al.,)

Petitioners,)

VS.)

UNITED STATES OF AMERICA,)

Respondent.)
_____)

NO. C 04-04264 RS

AND RELATED CASES:

C 04-04309 RS, 04-04398 RS,
04-04964 RS, 05-01123 RS,
05-01996 RS, 05-02835 RS,
and 05-03887 RS

San Francisco, California
Thursday, June 20, 2013

TRANSCRIPT OF PROCEEDINGS

APPEARANCES:

For Petitioners:

LATHAM & WATKINS
505 Montgomery Street - Suite 1900
San Francisco, California 94111

BY: STEVEN M. BAUER, ATTORNEY AT LAW

For Respondent:

U.S. DEPARTMENT OF JUSTICE
Tax Division
555 Fourth St., N.W. - Room 7217
Washington, D.C. 20001

**BY: JAMES E. WEAVER, TRIAL ATTORNEY
ADAM D. STRAIT, TRIAL ATTORNEY
ADAIR F. BOROUGHS, TRIAL ATTORNEY**

(APPEARANCES CONTINUED ON FOLLOWING PAGE)

REPORTED BY: Jo Ann Bryce, CSR No. 3321, RMR, CRR, FCRR
Official Reporter

APPEARANCES: (CONTINUED)

For Intervenors J. Paul Reddam and Clarence Ventures LLC:

LAW OFFICE OF DAVID W. WIECHERT

115 Avenida Miramar

San Clemente, California 92672

BY: DAVID W. WIECHERT, ATTORNEY AT LAW
JESSICA C. MUNK, ATTORNEY AT LAW

For Intervenors Thomas Gonzales and Birch Ventures LLC:

WOOD LLP

333 Sacramento Street

San Francisco, California 94111

BY: DASHIELL C. SHAPIRO, ATTORNEY AT LAW

Thursday - June 20, 2013

3:32 p.m.

P R O C E E D I N G S

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THE CLERK: Calling case C 04-4264, and all related matters, Shasta Strategic Investment Fund versus United States of America.

Counsel, please state your appearances.

MR. BAUER: Good afternoon, Your Honor. Steve Bauer for the various Strategic Investment Funds.

THE COURT: Good afternoon.

MS. MUNK: And good afternoon, Your Honor. Jessica Munk and David Wiechert on behalf of intervenors J. Paul Reddam and Clarence Ventures LLC.

THE COURT: Good afternoon.

MR. SHAPIRO: Your Honor, Dashiell Shapiro on behalf of Tom Gonzales and Birch Ventures LLC, intervenors.

THE COURT: Good afternoon.

MR. WEAVER: Good afternoon, Your Honor. James Weaver, Adam Strait, and Adair Boroughs on behalf of the United States.

THE COURT: Good afternoon.

This matter is on my calendar for a motion for summary judgment by the respondent, the Government; and also the various motions by the intervenors, various groups, with respect to the procedural question to abbreviated tolling

1 agreements in this matter.

2 As I generally do, let me go ahead and give you my sense
3 of where I see things having had an opportunity to go through
4 the voluminous submissions that I did receive, which I
5 appreciate.

6 As I understand it, this motion pertains, let's talk about
7 the summary judgment motion first, pertains to the petitions
8 that were filed by Presidio Growth as the Tax Matters Partner
9 contesting the FPAA's that were issued to I guess it's around 91
10 different partnerships, and it arises out of this extremely
11 convoluted investment strategy known as BLIPS.

12 I have now navigated through the extensive submitted
13 materials, and I have to say I'm inclined to grant the
14 Government's motion.

15 I think the undisputed facts do not reflect that these
16 transactions were foreign currency exchange investments that
17 were seeking to achieve a profit over their seven-year life;
18 but instead they were effectively a 60-day strategy that lacked
19 economic substance, and it was designed artificially to inflate
20 a participant's tax basis utilizing primarily this premium loan
21 component but other aspects as well, and the overriding purpose
22 was to generate tax losses.

23 With respect to the intervenors' motions, they are,
24 putting them together, directed to, and I realize there are
25 individual aspects to the various intervenors, but they go to

1 the question of authority to enter into tolling agreements; and
2 that to the extent that those are not valid, that there is then
3 statute of limitations issues that arise.

4 To put them together, I have to say I know that the
5 arguments are various conflict-of-interest problems. I don't
6 think those win the day. I think the agreements are effective
7 and valid; and that, therefore, the motions, some of them are
8 in the form of summary judgment motions, some of them are in
9 the form of opposition to the Government's motion for summary
10 judgment, but the intervenors' positions I don't think -- the
11 various intervenors, my initial read at least is that those
12 positions are not well taken.

13 So I'll look to the plaintiffs' side and the intervenors'
14 side to start. Why don't we start with the intervenors'
15 motions because those are a little clearer.

16 I will tell you also that I have to conclude these
17 proceedings, because I have a conference call that I have to
18 participate in, at 4:20. So it cannot go longer than that, and
19 I hope it will be less than that.

20 So the intervenors' counsel can begin.

21 **MS. MUNK:** Good afternoon, Your Honor. Jessica Munk
22 on behalf of intervenors J. Paul Reddam and Clarence Ventures
23 LLC.

24 **THE COURT:** Good afternoon.

25 **MS. MUNK:** I'm going to be addressing the Presidio

1 Growth extensions, the Tax Matter Partner extensions.
2 Mr. Wiechert is going to address Mr. Reddam's individual
3 extension. I will be addressing the conflict of interest
4 argument, as well as Alan Smith's lack of authority to sign for
5 Foraker and Logan, which is the other intervenor in this case;
6 and Mr. Shapiro is going to be addressing the remaining issues
7 regarding the invalidity of the Tax Matter Partner extensions,
8 and the various briefing he cited on that, and we're joining in
9 those arguments that Mr. Shapiro filed.

10 First, Your Honor, there are two additional exhibits that
11 I wanted to admit that I have given to the Government. They're
12 documents that we received after we filed our reply brief from
13 the Government on, I believe it was, the end of May. So I have
14 them labeled as Exhibits 54 and 55. I have given them to the
15 Government. I don't believe they have an objection, but if I
16 can hand them up for Your Honor.

17 **THE COURT:** Okay.

18 **MR. WEAVER:** No objection.

19 (Pause in proceedings.)

20 **THE COURT:** Okay.

21 **MS. MUNK:** The statute of limitations for assessments
22 attributable to partnership items is three years after the
23 later date from filing of the partnership return or the last
24 day for filing such a return.

25 Now, Mr. Reddam's partner was Foraker -- BLIPS'

1 partnership was Foraker Strategic Investment Fund. I'll refer
2 to it as Foraker.

3 Foraker filed its partnership return for the taxable year
4 1999 on April 13th, 2000. Now, the statute of limitations for
5 assessments against Foraker expired on April 15th, 2003.
6 Absent a valid extension to the three-year limitations period,
7 the FPAA issue to Presidio Growth on December 21st, 2004, is
8 untimely.

9 Now, generally a Tax Matter Partner may enter into an
10 agreement with the IRS to extend the limitations period and
11 that extension is binding on all the parties unless the Tax
12 Matter Partner has a conflict of interest.

13 Now, in 1997, John Larson and Robert Pfaff left KPMG to
14 form Presidio Advisory Services. They did so in order to
15 implement KPMG investment strategies that they helped develop.

16 **THE COURT:** Now, Mr. Reddam himself signs the consent;
17 correct?

18 **MS. MUNK:** He does, Your Honor.

19 **THE COURT:** So that's different than the *Transpac*
20 case, which is one of the ones that seem to be the principal
21 case on which you rely.

22 **MS. MUNK:** It is different, Your Honor, but we also
23 have challenges to Mr. Reddam's -- the validity of Mr. Reddam's
24 extension, and we believe that extension is also invalid.

25 **THE COURT:** Why?

1 **MS. MUNK:** Based on the conflict of interest given the
2 fact that Mr. Hastings, who is a representative of KPMG and
3 directly involved for implementing, marketing, selling BLIPS to
4 various people, that he had a conflict of interest. The
5 Government was criminally investigating KPMG for what they
6 believed was the largest tax shelter fraud case ever.

7 **THE COURT:** So everybody is -- these conflicts are
8 floating out there because Mr. Reddam is, you know, getting
9 advice and counsel from people that otherwise would have a
10 reason to be concerned because the Government is investigating.
11 He has no response -- once -- so, therefore, when he signs, we
12 just disregard it?

13 **MS. MUNK:** Well, Your Honor, when he signs, we don't
14 disregard it, but what we do is we look at who's representing
15 Mr. Reddam at that point. And I know Mr. Wiechert wanted to
16 mainly address this argument, but I can touch on it if this
17 is -- briefly and let him address it some more.

18 **THE COURT:** Go ahead.

19 **MS. MUNK:** But KPMG was being investigated by the IRS
20 and the Federal Government for -- it was basically conducting a
21 criminal investigation. We know that the Criminal
22 Investigation Division of the IRS was investigating this case
23 and made a criminal referral to the Department of Justice.

24 **THE COURT:** Right.

25 **MS. MUNK:** They were scrutinizing everything KPMG did,

1 and they believed that KPMG had essentially committed criminal
2 tax fraud. So the fact that the IRS is accepting waivers or
3 statute of limitation extensions from the very entity, KPMG,
4 that they believe has committed fraud, there's clearly a
5 conflict of interest.

6 And while this is different from *Transpac*, I think the
7 reasoning in *Transpac* still applies to our case.

8 **THE COURT:** Okay. Go ahead.

9 **MS. MUNK:** Do you want me to -- I can continue on this
10 point or I can go back to the --

11 **THE COURT:** Go back to your other argument.

12 **MS. MUNK:** Because we recognize that there are the two
13 extensions that you need to look at. I do believe the
14 Government wants to only look at the individual taxpayer
15 extensions and Mr. Reddam's extension; but I think as a
16 fallback, they do want to look at the Tax Matter Partner
17 extensions from Presidio Growth.

18 So in 1999, just to give some brief history of this,
19 Mr. Larson and Mr. Pfaff, along with David Amir Makov --

20 **THE COURT:** I did read the historical information.

21 **MS. MUNK:** Okay.

22 **THE COURT:** So that you need not go over with me
23 again. I know what happened in terms of the criminal charges
24 and where that played itself out, Mr. Larson, Mr. Pfaff, and
25 the like.

1 **MS. MUNK:** Okay, Your Honor. And I also -- and I
2 don't know if the Government is challenging this or not,
3 although they did in their papers, but there was an argument
4 that they raised that essentially because Mr. Larson didn't
5 sign for Presidio or Mr. Pfaff didn't sign for Presidio, then
6 there's no conflict.

7 We disagree with that, Your Honor. Presidio itself was
8 being investigated as well because that was the various
9 entities that Mr. Larson and Mr. Pfaff ended up forming to
10 implement these various --

11 **THE COURT:** What's the case authority for the prospect
12 that because there may have been an investigation going on with
13 respect to Presidio that, therefore, there's a disabling
14 conflict for purposes of their signing such that it binds the
15 partners?

16 **MS. MUNK:** Well, I think that's the -- I mean, that's
17 the *Transpac* case, Your Honor.

18 **THE COURT:** Okay, that's *Transpac* again. Okay.

19 **MS. MUNK:** I think it's absolutely *Transpac*. Presidio
20 and KPMG are being investigated by the IRS and they're being
21 criminally investigated. We know the whistle-blower contacts
22 the Federal Government in 2002 that summer; and then in around
23 October 2002, the Senate launches its investigation into these
24 various what they consider tax shelters.

25 And it's in March 2003, at that point the IRS realizes

1 they're up against the statute of limitations deadline and it's
2 about to expire, and they seek statute extensions from Presidio
3 Growth, the very entity that they're investigating that they
4 believe has engaged in criminal conduct.

5 And when you look at *Transpac*, that was the issue.
6 There -- it's very similar. While there might be a few
7 distinctions, it is very similar because there the IRS started
8 doing civil audits of the Transpac partnerships. It, just like
9 here, turned into a criminal investigation; and just like here,
10 we have several of the Tax Matter Partners who are being
11 criminally investigated.

12 Well, we know the Tax Matter Partner Presidio was being
13 investigated and its principals have been convicted. So it's
14 very similar, Your Honor.

15 And the Government knew that there was a conflict of
16 interest. And here we believe the Government did know that
17 there was a conflict of interest. They knew that Presidio and
18 KPMG had what they believed to have engaged in criminal
19 conduct, but they still accepted extensions from Presidio
20 Growth; and we believe that based on this conflict of interest,
21 it's invalid.

22 **THE COURT:** Okay.

23 **MS. MUNK:** One other point I wanted to highlight is
24 that in the *Leatherstocking* case, which is also a Second
25 Circuit opinion, there is some language in there that says that

1 the IRS may have -- I'm sorry, I'm trying to think how it's
2 worded; but essentially that when the IRS knew the Tax Matter
3 Partner was defrauding the limited partners, that may be enough
4 to put the IRS on notice.

5 And I think that language is very persuasive because if
6 you look here, the IRS had issued numerous summonses to KPMG.
7 Mr. Larson had responded to numerous summonses. They had tons
8 of documentation on BLIPS.

9 We know the criminal investigation unit of the IRS is
10 investigating; and at that point in 2003, which is over a year
11 after the investigation, they believed that Presidio, the Tax
12 Matter Partner, was engaged in fraudulent tax shelters. That's
13 what the IRS believed.

14 So that was enough to put the IRS on notice that when they
15 get extensions from the Tax Matter Partner, Presidio Growth,
16 that are going to bind the limited partners, there is a
17 conflict of interest. And I think *Transpac* and *Leatherstocking*
18 are directly on point with regards to that, Your Honor.

19 I was also going to address Mr. Smith, Alan Smith is one
20 that signs on behalf of Presidio, his lack of authority to
21 sign.

22 **THE COURT:** Okay.

23 **MS. MUNK:** Again, I think in the briefing I go through
24 pretty clearly the history of who actually is controlling this
25 company.

1 I believe that the IRS knew that Mr. Larson and Mr. Pfaff
2 are controlling it; but regardless, when you look at the
3 documents, Alan Smith essentially appears out of nowhere. I
4 don't see in the record of the documents we've been given from
5 the Government that there's actually a document that shows
6 Odd Eckholt, that was supposedly the director of HSM Growth
7 Holdings, was actually the director.

8 The documents have Mr. Larson and Mr. Pfaff all over them.
9 The records of incorporation and the corporate filings have
10 Mr. Pfaff and Mr. Larson.

11 One of the documents, Exhibit 55 that I handed up,
12 Your Honor, is a document from I believe it's October 2002, and
13 it's a document that the IRS had looked at when they were
14 trying to determine who essentially is in control of these
15 companies, and it lists Robert Pfaff as the president as late
16 as 2002; and this is at the same time that the IRS is seeking
17 to get extensions from Presidio Growth.

18 So based on all of that, I know Mr. Shapiro wants to
19 address the additional issues and as well he's going to address
20 the single-member conversion that the Tax Matter Partner
21 converted to a single member and was no longer the Tax Matter
22 Partner.

23 **THE COURT:** Okay.

24 **MS. MUNK:** And Mr. Wiechert was also going to address
25 Mr. Reddam's individual extension, Your Honor. Thank you.

1 **THE COURT:** All right. Mr. Shapiro, and then we'll
2 get to the Government.

3 **MR. WEAVER:** Your Honor, is there any way we can go
4 issue by issue since --

5 **THE COURT:** Generally I like to do that, but let's
6 get -- I would rather have -- it's really a limited amount of
7 time.

8 **MR. WEAVER:** Okay.

9 **THE COURT:** And I want to move it in this fashion so
10 we can get everybody an opportunity to say what they want to
11 say.

12 Go ahead.

13 **MR. SHAPIRO:** Thank you, Your Honor.

14 I'll try to briefly identify, I think, the key issues on
15 the statute, both the factual and legal issues, as to why the
16 Government should not prevail here.

17 First is the conversion to single-member LLC. I think
18 it's clear from the internal documents we've submitted, there's
19 internal IRS memoranda we cite to in our brief, that the IRS
20 had identified this as a significant litigating hazard; that if
21 the TMP converts from a partnership to a single-member LLC, it
22 terminates the status of the TMP and it can't sign consents on
23 behalf of the partnership, it can't receive the FPAA notice.
24 And this is significant because then the statute was never
25 tolled with the issuance of the notice.

1 The Government tries to make a distinction between a
2 termination of a partnership and a liquidation or a
3 dissolution, and that no such distinction can be made. There's
4 a specific revenue ruling on point, Revenue Ruling 99-6, which
5 says that when a partnership converts to a single-member LLC,
6 it's a termination that's also a liquidation.

7 Now, the regulations, the Tax Matter Partner regulations,
8 under 6231 make it very clear that if the entity liquidates,
9 that terminates its status as a TMP. It can't act on behalf of
10 the partnership.

11 **THE COURT:** So nobody could ever sign for that?

12 **MR. SHAPIRO:** No, that's --

13 **THE COURT:** There's no way you can consent?

14 **MR. SHAPIRO:** No, that's not true. There's a
15 procedure in the 6231 rights for the Government to designate a
16 new entity as a Tax Matters Partner, and that's what should
17 have been done here.

18 The Government had actual knowledge that Presidio had
19 converted to a single-member LLC. There's correspondence that
20 the Government knew of this from Revenue Agent Diaz that we
21 cite to in our brief. The Government had actual knowledge of
22 this; and because they had actual knowledge, I'm going to get
23 to it in a minute, the actual knowledge of the Government as to
24 the defects in the TMP status affect the question of whether
25 the statute was tolled.

1 Moreover, there's a case, *Roundhorse versus Commissioner*,
2 119 T.C. 157, it's a Tax Court case saying that the IRS can't
3 litigate contrary positions taken in a revenue ruling. So the
4 IRS can't stand up and try to argue that this wasn't a
5 dissolution of the TMP for tax purposes. When a partnership
6 converts to a single-member LLC, its status is terminated.

7 And this is very significant for tolling because the IRS
8 cites to the Ninth Circuit case of *O'Neill* saying that, you
9 know, even if there's a problem -- you know, there the TMP had
10 filed bankruptcy and then the TMP had filed a petition, and the
11 petition nevertheless tolled the statute. So the Government is
12 relying on this to say, "Similarly here, even if there's a
13 problem with the TMP status, the statute's still tolled."

14 Well, *O'Neill* doesn't apply here because in *O'Neill* the
15 Court was very clear that the IRS didn't know that the TMP had
16 filed for bankruptcy.

17 And there's significant authority in the area of tolling
18 of Tax Court petitions in tax cases where if the Government has
19 actual knowledge that there's a defect in the petition or in
20 the validity of the notice, then the statute can't be tolled.

21 One of these cases is *Greve versus Commissioner*. It's --

22 **THE COURT:** Are these cases all set forth in the
23 briefing that you provided to me?

24 **MR. SHAPIRO:** Well, we just -- *O'Neill* was first
25 mentioned in the Government's last reply brief, and we haven't

1 had a chance to respond to that. *Greve versus Commissioner*,
2 42 B.T.A. 142; and *Midland Mortgage Company*, 576 F.Supp. 101.

3 The Government can't rely on tolling when its own errors
4 led to the invalid notice and when the statute had already
5 expired. The statute had already expired as a legal matter
6 because there were legal defects in the TMP status.

7 And, as a factual matter, we made a number of arguments on
8 burden of proof, how the burden of proof should be shifted to
9 the Government. And here there's simply, in terms of looking
10 at the record on summary judgment as to whether this entity had
11 authority and whether the individuals that signed on behalf of
12 the entity had authority, there's simply not a complete record;
13 and we identified three reasons the burden of proof should
14 shift, and the Government hasn't responded to any of them.

15 One is Section 7491 requires the burden --

16 **THE COURT:** There really is a limited amount of time.

17 **MR. SHAPIRO:** Okay.

18 **THE COURT:** There's a lot of stuff we have to do, and
19 I really want to bring to a close the intervenors' motions so I
20 can get to some discussion on the other issues.

21 So sum up in another minute. I want to hear from the
22 Government, and then I want to move to the next motion. I'm
23 sorry, but we just -- time is --

24 **MR. SHAPIRO:** No, I understand.

25 **THE COURT:** -- crunched.

1 **MR. SHAPIRO:** Okay. And the final point I would make
2 is that even if you accept -- we have arguments as to the
3 validity of Mr. Gonzales' consents; but even if you accept the
4 validity of those consents, the fact that -- the important
5 point, and we actually wrote an article about this in *Tax Notes*
6 that came out on Monday that was cited to in our brief
7 yesterday, even if the individual consent was valid through
8 2005, when Mr. Gonzales dismissed his Tax Court petition in
9 2008, the consent, the stipulation he signed did not extend the
10 statute for partnership items.

11 And the law is very clear that you have to expressly state
12 the extension for partnership items. That's why in the
13 original consents that were signed it states that explicitly
14 the partnership items were extended.

15 The IRS failed to include that language in the 2008
16 extension and, therefore, the statute expired. Even if it --
17 the statute was survived through 2005, it didn't survive past
18 2008.

19 It's 2013 now, and we identified a number of legal and
20 factual issues in our brief as to why the consents on behalf of
21 Presidio were not valid, why the consents on behalf of
22 Mr. Gonzales were not valid. We believe the burden of proof
23 should shift. We believe there's a lot of issues we identified
24 that the Government never even responded to: The fact that
25 there were multiple consents signed, the second consents

1 invalidated the first consent, Odd Eckholt never had proper
2 authority. There's no evidence in the record.

3 **THE COURT:** Okay. Thank you.

4 **MR. SHAPIRO:** Thank you.

5 **THE COURT:** The Government.

6 **MR. WEAVER:** Thank you, Your Honor.

7 Let me try to address these maybe in reverse order here.
8 First, with respect to the stipulation, the Tax Court
9 stipulation that Mr. Shapiro is talking about, his reading of
10 that is just wrong. And if you -- it's Exhibit 10, Docket
11 64-3. It's very clear that the purpose of that stipulation is
12 to take care of items that are not in the partnership
13 proceeding.

14 And I think a fair reading of that is that whatever is in
15 the partnership proceeding is going to be preserved for the
16 partnership proceeding, and it's not a consent or an extension
17 whatsoever.

18 Furthermore, it's our position that once we received a
19 consent from Mr. Gonzales that took us past the issuance of the
20 FPAA and there was a timely petition filed by Presidio Growth,
21 that's all we need. So that's all I have to say about the
22 stipulation.

23 More broadly, our logic is as follows:

24 If the FPAA notices were valid, and we believe they are,
25 and I want to speak to that briefly, and we have individual

1 consents for both Mr. Reddam and for Mr. Gonzales, that's it.

2 **THE COURT:** How about the conflict issues? I mean,
3 their principal argument is, okay, you've got individual
4 consents and that perhaps in one sense takes you out from under
5 the *Transpac*, some of *Transpac*; but they're saying that it
6 doesn't mean much because of the various conflicts that they
7 identified by virtue of the criminal investigation.

8 **MR. WEAVER:** Well, Reddam's position is slightly
9 different than Gonzales'.

10 **THE COURT:** Right.

11 **MR. WEAVER:** Gonzales' is simpler so let me take that
12 first. Gonzales, I think it's fair to characterize this, if
13 their individual consents are good, they're done.

14 They do not allege that Mr. Gonzales was somehow
15 conflicted himself out when he signed. They're arguing that
16 the consents we received from the Tax Matters Partners are
17 invalid; but the law under the Tax Code is if you get a consent
18 from the individual partner, you're done as to that partner.

19 We got consents from Mr. Gonzales.

20 **THE COURT:** Even if that partner has been receiving
21 advice and counsel from advisers who are, according to their
22 argument, motivated to curry favor with the Government?

23 **MR. WEAVER:** Well, Gonzales did not brief that. He
24 may have adopted the Reddam brief, but there's nothing in the
25 record to show that Gonzales was unduly influenced somehow.

1 You know, who was influencing him? Because as far as we know,
2 he wasn't talking to Mr. Larson or Mr. Pfaff.

3 **THE COURT:** Okay. Let's talk about Reddam now.

4 **MR. WEAVER:** Okay. With respect to Reddam, I will
5 just refer you, with respect to the conflict of interest, to
6 two documents. One Ms. Munk filed. It's Docket Number 130-2
7 in the '63 case. It's her Exhibit 53, and it's a conflict of
8 interest waiver with respect to the person she alleges had a
9 conflict that was advising Mr. Reddam to sign his individual
10 consents. That person is Mr. Hasting of KPMG.

11 **THE COURT:** Right.

12 **MR. WEAVER:** All I want to say about that is, there it
13 is. The conflict is identified and, lo and behold, he signs
14 anyways. What more can you ask? I mean, we've briefed this.

15 The other thing to say about the conflict of interest
16 argument in general, staying with that for a second, is it's
17 not enough to allege or suspect or speculate about conflict.
18 That's the Ninth Circuit case of *Phillips*. You have to show an
19 actual conflict.

20 They're the moving party. They have the burden of proof.
21 They haven't met that burden of proof. And, moreover, here
22 there's a fundamental difference between their position, their
23 litigating position here, and *Transpac*; and that is, they
24 wanted to sign consents. They signed consents.

25 In *Transpac* the real problem the Second Circuit had was

1 that the IRS went to the individual partners and they refused;
2 and then, only and then, did they go to the Tax Matters Partner
3 who was cooperating.

4 So that's just not the case here, and that's all I have to
5 say about that.

6 **THE COURT:** Okay. Yes?

7 **MR. WEAVER:** I have -- quickly if I can, Your Honor,
8 the other thing I would just add is the other hook that we have
9 to cross to get where we need to be is the validity of the
10 FPAA, and Mr. Shapiro raises that in the Gonzales brief,
11 Mr. Wood does.

12 And I would refer you to three Ninth Circuit cases.
13 *Stone* -- well, let me rephrase that, that were affirmed by the
14 Ninth Circuit: *Stone Canyon Partners v. Commissioner, Seneca*
15 and *Anderson*. All of those cases, plus a couple others, the
16 *Chomp* case in particular, are directly contrary to
17 Mr. Gonzales' position here.

18 And the idea is, we sent out not only FPAAs, the notices,
19 to everybody in the world, which should be enough, we sent it
20 out generically to a Tax Matters Partner care of the address;
21 and the case law says, if you do that, that's fine. As a
22 matter of fact, the *Chomp* case says this is a valid mechanism
23 for doing this. It's in the regulation, and it's especially
24 apt in confused circumstances.

25 And if you read the papers, I was thrilled that

1 Mr. Shapiro wanted to submit this stuff in camera yesterday
2 because it lays out perhaps better than I can the legal
3 analysis that the IRS had to go through.

4 I mean, the IRS was between a rock and a hard place. On
5 the one hand, maybe Presidio Growth was still a Tax Matters
6 Partner. He's wrong about his legal analysis on whether
7 there's a difference between state law and tax dissolution. In
8 fact, there's a revenue ruling, I think it's notice -- we cite
9 to it in our papers. I think it's 2480 or something like that,
10 2488, where the IRS has specifically indicated a single-member
11 LLC can be a Tax Matters Partner.

12 So on the one hand we have information. The IRS was
13 clearing mulling this over. On the other hand, if they just
14 went out, as Mr. Shapiro suggested we do, and appoint another
15 Tax Matters Partner, you know what? They'd be right back in
16 here saying, "Oh, you did it wrong. You should have stayed
17 with Presidio Growth."

18 We did our best. We sent notices out to everyone and we
19 complied with the statute.

20 **THE COURT:** All right. I want to move on to the
21 substantive motion.

22 So who wants to speak on the motion for summary judgment?

23 **MR. BAUER:** Your Honor, if your hard stop is 45
24 seconds ago, I would be very willing to come back tomorrow
25 morning for 15 minutes to be able to say my piece.

1 **THE COURT:** I've got lots to do tomorrow morning.
2 This is your moment. Go for it.

3 **MR. BAUER:** Okay. My shining moment.

4 Well, I will agree with you that these are convoluted
5 investments, but they're actually quite interesting when you
6 get in them; and I think my summary statement is for you to
7 make a judgment of whether these will work or whether they
8 don't under the theories that the Government's presented.
9 You're absolutely making decisions of fact because there are
10 fact issues here. You can't possibly --

11 **THE COURT:** Summarize the fact issues for me.

12 **MR. BAUER:** There are challenges on the economic
13 substance doctrine.

14 **THE COURT:** Right.

15 **MR. BAUER:** Two prongs in the Ninth Circuit, one
16 objective, one subjective.

17 **THE COURT:** Right.

18 **MR. BAUER:** The objective one, the case they cite says
19 no practical economic effects; right? And, so, that's a fact
20 question.

21 Could someone make money if the Argentine peso devalued?
22 Yes, in fact, it did devalue a year later.

23 **THE COURT:** I don't think the standard is could
24 conceivably some money be made during the 60-day window; and I
25 think it's pretty compelling that out of, I forget how many

1 investors are involved, two of them stay on more than 60 days.

2 And with Mr. Rifkin's testimony and the other testimony in
3 the record, I don't think there is a dispute that the investors
4 go in and out in 60 days. And the idea that the peg is going
5 to be broken in 60 days, there's evidence that says it is
6 almost infinitesimal that that would occur.

7 And the standard is not conceivably could money be made.
8 It's -- I forget the language, but there's case law that says
9 it has to -- there has to be substantive economic benefit that
10 is being sought from this, and the undisputed facts here show
11 this was designed to generate tax losses.

12 Go ahead. Sorry to take part of your time, but go ahead,
13 Mr. Bauer.

14 **MR. BAUER:** High-risk, high-return investment. That's
15 what the Larson declaration says. That's what the Pfaff
16 declaration says. That's what Makov's long deposition said,
17 which is the only testimony from him that's admissible in this
18 case.

19 So absolutely high risk, but potentially very high
20 returns. It could happen in 60 days. It could happen in a
21 year. It could happen in two days.

22 One of the key evidence, pieces of evidence, that shows
23 that that's a fact is it is undisputed here, conceded by them,
24 that the banks hedged this investment. They didn't want to
25 have a risk that the peg could break and they could lose all

1 their money, so the banks spent money hedging the investment.

2 Are there practical economic effects? Certainly. This is
3 not a made-up investment. It is an investment that is
4 admittedly high risk, high return, but you would have to be
5 making some factual finding that somehow that this is not a
6 high-risk, high-return investment.

7 **THE COURT:** No. I'd be taking into account the
8 standard. The standard is, where perhaps you and I part
9 company, is what I'm hearing you saying is, if there's any
10 conceivable way money could be made out of this investment,
11 then, therefore, summary judgment should be denied.

12 And I think the standard is -- the undisputed fact
13 analysis goes to whether or not when the facts of this
14 investment reflect whether or not it has substantial economic
15 aspect to it, and I don't think there are any undisputed facts
16 that indicate it was anything but a loss-generating enterprise.

17 **MR. BAUER:** And what you've done there, right, is
18 you've moved into the subjective prong of it; and the
19 subjective prong is: Did investors, did the people in charge
20 of the partnerships believe they could make money on it? And
21 you have in the record, you know, as a factual statement; and
22 these guys will come in here and testify: Larson, Pfaff, and
23 the Makov deposition and Mr. Reddam's declaration.

24 If you're making that decision, you're saying, "I don't
25 believe their testimony," and you haven't seen it; and you

1 would be doing it on the basis of declarations from people
2 that you haven't seen that are also contradicted by all the
3 evidence of what they used to say before the Government got
4 cooperation agreements out of them.

5 Part one is objective and the test is not was their
6 substantial. You can have -- think of all these venture
7 capital investors. They're going on 2 percent chances, but
8 there's a huge venture capital industry. Think of all the
9 low-risk -- I mean, high-risk, high-return investments that
10 people with a lot of money would make. This isn't an
11 investment that you or I would make. This is something --
12 these are ones that people looked at that and said, "My
13 goodness, I can get in and have a 40-million-dollar short on
14 the Argentine peso, and" --

15 **THE COURT:** Within 60 days?

16 **MR. BAUER:** Within 60 days.

17 **THE COURT:** Where's the evidence that there is any
18 realistic prospect within that 60-day window? And I think it's
19 undisputed effectively that it's an in and out in 60 days.

20 **MR. BAUER:** Well, the --

21 **THE COURT:** And, so, if it's in and out within 60
22 days, where is there any evidence that this is realistically
23 the breaking out of the currency pays? Even your own people
24 are saying there's no real prospect for that.

25 **MR. BAUER:** I disagree, Your Honor. And the test

1 isn't realistic by whose standard. What are the chances? All
2 right. What are the chances? Nobody knows. You can't predict
3 when the lightbulb's going to burn out exactly. You know it's
4 going to burn out, but you can't predict when.

5 We know these are valid investments because people make
6 them all the time. Everyone is shorting and going long
7 currencies all the time; and if the Court's logic were
8 accurate --

9 **THE COURT:** Yeah, but they don't have all these other
10 built-in component parts to this transaction which, as you look
11 at them, are designed for purposes of inflating the basis for
12 purposes of generating losses.

13 **MR. BAUER:** No one is denying that this was a
14 tax-based investment. No one is denying that. All these
15 people went in there having made gains and wanting to have this
16 possibility of getting this tax benefit. So no one's denying
17 that at all. I mean, KPMG and Brown & Wood wrote the opinions.

18 Of course it's tax based, but the test isn't a realistic
19 possibility based on, you know, your economics or my economics.
20 It's what an investor actually thought, and did the investor
21 believe that this was a good investment for them, did he think
22 he could make money. Were there practical economic effects?
23 Certainly, people made and lost money on those pegs -- on those
24 investments when they happened.

25 I understand what you're saying, and I understand that in

1 a bench trial I'm going to be swimming upstream; but without
2 actually seeing the evidence and hearing the people testify,
3 with all due respect, I think you're making fact and
4 credibility judgments about the Larson declaration, the Pfaff
5 declaration, the Makov deposition testimony, which even in
6 advance of a bench trial is not appropriate at the summary
7 judgment level.

8 I think that when you see the testimony and hear what
9 these people have to say, I might be able to change your mind.

10 **THE COURT:** Okay. Thank you.

11 The Government?

12 **MR. WEAVER:** Yes, Your Honor.

13 Let me briefly address why this case is, in fact,
14 appropriate to dispose of on summary judgment, and I want to
15 start out with the legal standard which Mr. Bauer did not get
16 correct.

17 He did cite the sham test is whether a transaction had any
18 practical economic effects on the creation of income tax
19 losses, and there is a subjective and an objective side. But
20 the fact of the matter is, and the standard is not contradicted
21 in the *Casebeer* case, which is the leading Ninth Circuit case,
22 the lack of economic substance alone suffices to invalidate a
23 transaction even if there's some subjective belief,
24 unreasonable belief, on the part of a taxpayer that there might
25 be some profit potential there.

1 What's the authority for that? Well, the authority is the
2 Fifth Circuit case of *Klamath* which cites to the Federal
3 Circuit, which is the *Coltec* case, the *Coltec* at the Federal
4 Circuit level; the Third Circuit; the Tenth Circuit.

5 And then there's this, and I think this seals the deal,
6 and that is Footnote 8 out of *Casebeer* is addressing an
7 argument similar to the one Mr. Bauer just made about
8 subjective intent. Quote: (reading)

9 "The presence of a business purpose does not entitle
10 a transaction to be recognized for federal tax purposes
11 where objective indicia of economic substance indicating a
12 realistic potential for economic profit are not manifest."
13 Then it says: (reading)

14 "Although this statement conflicts with prior Tax
15 Court authority," citing to what became a Fourth Circuit
16 case, *Rice World*, here's the kicker, quote, "it is not
17 inconsistent with our flexible application of the
18 two-prong test."

19 Now, Your Honor, we cited to the Scott --

20 **THE COURT:** Was that on summary judgment?

21 **MR. WEAVER:** I believe that was a trial, Your Honor,
22 but --

23 **THE COURT:** All right. That's of some consequence;
24 isn't it?

25 **MR. WEAVER:** Well, no. The idea, Your Honor, is that

1 if this transaction is so far afield, you do not have to
2 take -- if there is -- if you can decide beyond any reasonable
3 dispute that this transaction lacked substance, you can stop
4 right there.

5 And given that circumstance, what's in evidence? Well,
6 there is a very general declaration from Mr. Larson and
7 Mr. Pfaff; and, you know, they talk about "I believed," "I
8 understood," but there's no objective analysis.

9 One of the reasons that this case is ripe for summary
10 judgment, there's only one objective expert that's going to
11 even appear at trial. Now, that's Dr. DeRosa.

12 **THE COURT:** Your expert.

13 **MR. WEAVER:** Our expert, the only one.

14 But there's another reason, and that is, what's the
15 transaction that matters? And there's plenty of case authority
16 for this, both the *Coltec* case; there's a Third Circuit case,
17 *ACM; Sala*, a Tenth Circuit case. We cited to these. And that
18 is, the transaction that matters is the one that creates the
19 tax benefit.

20 So the undisputed testimony is that, you know, the tax
21 benefit was created by a premium loan; and the record is devoid
22 of any contrary evidence that that premium loan, the high
23 front-loaded interest that was supposed to be of such great
24 convexity benefit or front loading it, that got wiped out.
25 That got wiped out, Your Honor, by the simultaneous execution

1 of a swap arrangement.

2 Now, that's addressed in DeRosa's opinion. If I had more
3 time, I had some charts I wanted to take you through, but let
4 me refer you to two additional exhibits in addition to the ones
5 that I talked about in our papers that I think are just
6 incredibly compelling.

7 One is our Exhibit 812. It's a spreadsheet which Presidio
8 produced to the Government, so it's an internal Presidio
9 document, that shows how the transaction in the Shasta case was
10 unwound.

11 And keep in mind, Larson and Pfaff have declared that all
12 these transactions are basically the same thing.

13 Exhibit 812, Your Honor, if you take the loan premium
14 amount that was originally advanced in Shasta, \$35.5 million,
15 and then you look over how they unwind the transaction, there's
16 a prepayment penalty under the premium loan. You add up the
17 prepayment penalty and the swap termination fee, boom, you have
18 \$35 million.

19 They repay the principal dollar for dollar. What interest
20 do they end up paying? The swap interest rate. That's a
21 low-interest rate. It's a market interest rate. There's no
22 convexity associated with a market interest rate because the
23 price doesn't change on a bond that has a floating interest
24 rate when interest rates change.

25 And, so, Your Honor, looking at the other exhibit,

1 Exhibit 835, that's their Form 1065 tax return, what did they
2 report? These wonderful high-interest rate benefits of this
3 premium loan, is that what they reported on their tax return?
4 Absolutely not.

5 Because if you look at the unwind sheet, the premium
6 interest is over \$2 million. They report as investment
7 interest expense something on the order of 1.2 million. And
8 what is that? It's precisely two things; and we know this
9 because, thanks to Mr. Bauer, I didn't submit this, he
10 submitted a work sheet, I think it's Exhibit T, and you can
11 trace through to the amount on the partnership K-1s by adding
12 two things: The additional margin amount, which is listed
13 there, to the swap interest.

14 Those two things will add up in the Shasta case to
15 1.2 million. They'll add up to whatever they did in Belford;
16 but the idea, Your Honor, is that exactly precisely what is
17 this in economic reality? It's a floating-rate note for the
18 full amount of the funding amount, and that doesn't provide any
19 economic benefit that the plaintiffs claim it does.

20 Finally, let me just also --

21 **THE COURT:** Well, but doesn't -- I mean, Mr. Bauer's
22 point seems to be that even granting all of those benefits in
23 terms of tax benefits that these investors are going to get,
24 they have the upside potential of some benefit, albeit a very
25 risky and perhaps unlikely event, that there's going to be this

1 breakout of the currency peg and the Argentine peso is going to
2 go crazy and they're going to benefit.

3 **MR. WEAVER:** That had nothing to do with the loan
4 transaction. The loan proceeds were invested in Eurodollar
5 rolls that DeRosa explains are nothing more than U.S. time
6 deposits. In fact, it's just incorrectly stated in
7 petitioner's brief.

8 **THE COURT:** There was some currency trading that
9 actually did occur, the minimal.

10 **MR. WEAVER:** The minimal currency trading -- these
11 forward contracts in the Argentine peso and Hong Kong dollar
12 had zero value at the outset. They only have value if
13 something goes awry and the peg breaks.

14 And the testimony of the only objective person in the
15 case, DeRosa, who advanced an objective opinion and analysis,
16 is that those were supported by the small amount that the
17 taxpayer put in.

18 All of the loan funds, they were rolled over for amount of
19 interest that was less than they were paying on the loan. It
20 was a guaranteed money loser with the loan funds, and that was
21 intentional because then you can squeeze out an investor that
22 stayed in too long and didn't just take the tax benefits.

23 And with respect to the currency forwards having been
24 funded by those small taxpayer margin, having nothing to do
25 with the transaction that matters here, which is the loan

1 transaction, we also submitted some declarations. We have a
2 declaration from the HVB banker Domenick DeGiorgio who says
3 that the loan had nothing to do with the Hong Kong dollar
4 trades that had this remote possibility of earning a profit.

5 Likewise, we submitted the equivalent of essentially a
6 30(b)(6) declaration from Deutsche Bank and I believe also from
7 HVB Bank. They basically say the same thing.

8 So, Your Honor, the short of it is, it's the loan
9 transaction that mattered. That's the way that the *Klamath*
10 case was analyzed. We don't agree with everything in the
11 *Klamath* case but Judge Ward in the *Klamath* case looked to the
12 loan transaction.

13 Now, I haven't really had an opportunity to address, and I
14 know I'm running up against your deadline, Your Honor, but, in
15 addition, if you actually look at the loan agreements and
16 start, you know, going through the terms, the loan collateral
17 was locked up. You had to actually have 101 and a quarter
18 percent on collateral with the bank.

19 **THE COURT:** Calm down, Mr. Bauer. You don't -- you
20 know, it's not appropriate to go through histrionics when --

21 **MR. BAUER:** I'm sorry, Your Honor. It's outrageous.

22 **THE COURT:** -- your counterpart is making arguments.
23 I know you think it's outrageous, but calm down.

24 **MR. BAUER:** Okay.

25 **THE COURT:** Go ahead.

1 **MR. WEAVER:** And if you look at the terms of the loan,
2 it's not just 101 and a quarter percent, because there is a way
3 that they have to value the collateral. It takes it up,
4 according to DeRosa, to something like 101.6 percent.

5 So there is just no way, if anything started going bad,
6 these trades would have been closed down by the bank and that
7 would have been it.

8 These were tax-motivated deals. There was no reasonable
9 chance of making a profit.

10 And with respect to the penalties, because I don't want to
11 forget about the penalties, I need to tell you two things.

12 First, petitioner's have briefed the penalties. We've briefed
13 the penalties. We didn't really do them justice. The issue
14 about subject matter jurisdiction on penalties and the
15 40 percent are on appeal to the Supreme Court. It's the
16 *Woods/Tesoro* case. So that remains on appeal.

17 But what do we have here? We have a situation,
18 Your Honor, where Mr. Makov, Mr. Larson, and Mr. Pfaff
19 certainly had to know at a minimum that this was a negligent
20 tax shelter as structured because they, in fact, admitted it.

21 In fact, one of the things we put into evidence was the
22 Rifkin declaration; and you can tell from the Rifkin
23 declaration that there was a Dallas meeting, and in that
24 meeting Makov actually says that there was only a very remote
25 chance for profit.

1 **THE COURT:** I'm anticipating what your counterparts
2 will argue. Aren't you now selecting out certain aspects of
3 declarations and ignoring others? In other words, isn't that,
4 as according to their argument, the factual dispute that we're
5 going to get to because people like Pfaff and Larson are
6 providing at various other points along the path declarations
7 or statements that reflect a different view?

8 **MR. WEAVER:** There is nothing in the record that
9 specifically counteracts the reality that the swap canceled out
10 the loan agreement, and there is -- that's as far as you really
11 need to go.

12 But let me close by referring you to the *Scott v. Harris*
13 case; and although I can't be as exciting as that case, that's
14 the case where there are two wildly different versions of what
15 happened in a high-speed car chase between the police and a
16 driver, and I think the driver ended up being a quadriplegic
17 and sued.

18 And, you know, I think it went up through the Eleventh
19 Circuit, and the nonmoving party was the driver who had been
20 rammed by a police car. And, so, the Eleventh Circuit says,
21 "We can't resolve this on summary judgment. There are two very
22 differing versions." And the Supreme Court said, "Yeah, but
23 for one thing, there's a videotape."

24 **THE COURT:** I know, that's a very controversial
25 decision and that one -- yes, the Supreme Court did look at

1 that videotape. Now, whether or not that's consistent with
2 other Supreme Court decisions as to whether or not the
3 Appellate Court should be looking at that kind of evidence is a
4 different proposition. But, okay, I hear you. I understand.

5 **MR. WEAVER:** And, so, if you look at that unwind sheet
6 as I told you, when you look at the documents, you don't even
7 need the testimony. It was guaranteed that this was a
8 floating-rate note that didn't provide any real tax benefits.
9 Economically that's all this transaction was at best.

10 **THE COURT:** All right. Mr. Bauer?

11 **MR. BAUER:** Okay. I apologize again, Your Honor. I'm
12 sorry. I think it's the time pressure of having on a summary
13 judgment --

14 **THE COURT:** You're a fine advocate who's an advocate,
15 and I understand that.

16 **MR. BAUER:** Okay. But I do apologize sincerely.

17 But he stood up and made about 10 really fast factual
18 arguments to you, and just illustrating why this is a trial and
19 not a summary judgment case.

20 For example, he's talking about Mr. DeRosa and whether the
21 loan is ever used in these investments. Well, in their own
22 brief on page 35, the Government says, "Yes, the loan is used
23 as collateral."

24 When I take Mr. -- what's his name? -- DeRosa's deposition
25 and say, "So you say that the loans weren't used as collateral,

1 how could that be?"

2 My clients swear that they are, swear they believe they
3 are. Makov testifies in a deposition with great detail, you
4 know, with supporting documents how it was used.

5 And what does DeRosa say? He said, "Well, somebody once
6 called me and told me I didn't have to do that."

7 I said, "You're kidding me? You're the big expert for the
8 United States Government, a key point in the case and who
9 called you? What did they say?"

10 "Oh, it's, like, a guy called me."

11 And you're saying that's an undisputed fact? I mean, it's
12 laughable on its face.

13 The idea that the swap negates the loan, that's just
14 factually wrong. It's not like a mortgage where you refinance
15 a mortgage and then the loan is gone. A swap is a hedge. So
16 if I'm long, if I'm long on a stock and then I short the stock
17 too, it doesn't mean I don't own the stock. It means I'm long
18 and I'm short. I have two different contracts, and there are
19 tax consequences to both.

20 So to say that -- I mean, that's just factually wrong, and
21 there's no person who can declare that to be truthful; and our
22 testimony will be, no, that's not truthful.

23 You know, just one after the next, after the next, these
24 are all fact issues.

25 Your Honor, I don't know, apparently our briefs maybe

1 didn't make it clear enough when you say that the actual
2 currency forwards were negligible. They weren't. This was
3 big-time money. This was probably -- the hypothetical that
4 they always used would be a hundred-million-dollar loan. It
5 would have a 60-million-dollar premium and \$60 million would be
6 the notional value of these currency forwards.

7 So if, like as we've shown, all these different currencies
8 that broke during the 1990s, if the Argentine peso had broken
9 during that time and, you know, it devalued, it devalued
10 70 percent, a person that has a 60-million-dollar investment
11 there would make \$42 million.

12 I mean, this was big time. You know, KPMG, Brown & Wood,
13 fancy investors. There's a lot of money involved in it. None
14 of these investments were negligible.

15 One of these key points of the investment, as folks will
16 testify, was that the investment was nonrecourse. So investors
17 could go in there, get access to these very big currency plays
18 without putting their other, you know, fortunes at risk; and
19 then they had a possibility that, because of the use of the
20 loan, they would get a tax benefit. They knew it wasn't for
21 sure, but they knew -- they thought that someday they'd get a
22 day in court to say whether -- you know, to analyze the tax
23 aspects of this.

24 **THE COURT:** It's not a possibility of tax benefit.
25 That, they were somewhat assured of; wasn't it? It was

1 possibility of upside profit.

2 **MR. BAUER:** No, no, no. The opinion letters and the
3 way all this IRS stuff works is the opinion said, "It's more
4 likely than not you're going to get your tax benefit." Nobody
5 promised everybody they would get the tax benefit.

6 When I first got into this, Your Honor, there's all these
7 different levels of legal opinion that you can get under the
8 IRS Code, and this one is more likely than not; meaning you'll
9 get your day in court and someday Judge Seeborg will say
10 whether you get that or not.

11 My last point, and this was in the brief, you know, there
12 is no loan that is morally superior to any other loan. And
13 while he says, "Oh, a premium loan, how could this -- this is
14 some weird loan," it's not. There's sections in the IRS Code
15 going back to, I think, the '30s talking about tax treatments
16 of premium bonds, which is what a premium loan is.

17 So a mortgage is like the ultimate premium loan because at
18 the end of your payment period, you don't owe anything. You
19 know, a bond you borrow money, you pay interest, and then you
20 have to pay the principal back at the end, but there's no
21 reason it has to be that way. There's negative amortization
22 loans in which you owe more at the end. There's ones where you
23 pay -- Makov talked about in his deposition and showed that
24 there are many instances where people borrow a premium. For
25 some reason a lot of municipalities borrow using premium loans

1 because they're trying to adjust their cash flow in some way.

2 So just to say, "Ah, this is some crazy loan so that, you
3 know, you should throw out the transaction because of that," I
4 mean, that's just factually wrong.

5 **THE COURT:** I don't hear the Government arguing that
6 because there is a premium loan here that it's, by definition,
7 some sort of sham. I hear them saying that you look at this
8 entire -- you have to step back and look at the whole
9 transaction and you have to look at the premium loan component
10 in terms of how it works in this investment, not that there's
11 something nefarious in and of itself in a premium loan
12 structure.

13 So I didn't hear them say, "Oh, you know, just look. You
14 see that there's a premium loan component to this and,
15 therefore, it's a tax shelter that is designed purely to obtain
16 tax losses."

17 They're saying, "Look at this whole transaction. Look at
18 the 60, 120, 7-year life, various other components of this.
19 Step back and look at it all and see what it's designed to do."

20 **MR. BAUER:** I hear what you're saying. That's the
21 broadest economic substance point, which is, can you make money
22 on this overall scheme if the peg breaks, can you make money.
23 We sort of talked about that.

24 The loan argument that they make is a little bit
25 different. The loan argument, as I understand it, is that, you

1 know, we say and they now say that the loan is necessary
2 because it serves as collateral for the investments. Okay. So
3 it's used in the investment program in that way, and that's
4 what the KPMG opinion said also.

5 What I hear them to say is that the premium loan doesn't
6 make a difference. They say the premium doesn't help you, and
7 I understand that argument to be, "Look, you could have used
8 some other kind of loan and you wouldn't have gotten these
9 possible tax benefits."

10 And my argument is: No loan is morally superior to any
11 other kind of loan. Of course, they chose the premium loan
12 because of the premium bond and liability sections under the
13 IRS -- in the IRS Code. So they were trying to get a tax
14 benefit by doing a particular kind of loan, and there's nothing
15 that prevents anybody from doing that.

16 So that -- I think I -- if you understand that argument,
17 Your Honor, it shows that a loan is necessary. It doesn't
18 matter what kind of loan, and any taxpayer can choose the kind
19 of loan that is most advantageous. If I want to borrow money,
20 I can do it through a mortgage. I can do it through a line of
21 credit. Some might be deductible, it might not. I can choose
22 the way I'd like to borrow the money in order to get a tax
23 benefit. It doesn't make it suspect.

24 **THE COURT:** Okay.

25 **MR. BAUER:** Okay.

